

Austin, Lewis & Rogers, P.A.

ATTORNEYS AND COUNSELORS AT LAW

DANIEL S. LEWIS
(1940-1981)

WILLIAM FREDERICK AUSTIN
E. CROSBY LEWIS
TIMOTHY F. ROGERS
RICHARD L. WHITT
RAYMON E. LARK, JR.
JEFFERSON D. GRIFFITH, III*
EDWARD L. EUBANKS
W. MICHAEL DUNCAN

COLUMBIA OFFICE:
CONGAREE BUILDING
508 HAMPTON STREET, SUITE 300
POST OFFICE BOX 11716
COLUMBIA, SOUTH CAROLINA 29201
TELEPHONE: (803) 256-4000
FACSIMILE: (803) 252-3679
WWW.ALRLAW.COM

WINNSBORO OFFICE:
120 NORTH CONGRESS STREET
POST OFFICE BOX 1061
WINNSBORO, SOUTH CAROLINA 29180

TELEPHONE: (803) 712-9900
FACSIMILE: (803) 712-9901

* ALSO MEMBER NORTH CAROLINA BAR

September 19, 2006

VIA ELECTRONIC FILING

The Honorable Charles L. A. Terreni
Chief Clerk and Administrator
The Public Service Commission of South Carolina
101 Executive Center Drive
Columbia, South Carolina 29210

Re: Docket No. 2005-3-E
Duke Power Company LLC d/b/a Duke Energy Carolinas, LLC
("Duke Energy Carolinas" or the "Company")
**Response to the South Carolina Office of Regulatory Staff ("ORS") Fuel
Study**

Dear Mr. Terreni:

Duke Energy Carolinas is in receipt of the, "Study of Duke Energy Carolinas Fuel Expenses" (the "Study") prepared by the ORS and filed in the above-referenced docket. The Company has thoroughly reviewed the Study and discussed it with the ORS.

Duke Energy Carolinas provided certain comments on the Study in response to questions from the Public Service Commission of South Carolina ("Commission") during the recent hearing in Docket No. 2006-3-E, and in that hearing, Duke Energy Carolinas indicated that it planned to provide a formal written response to the Study as well. Duke Energy Carolinas offers the following comments on the Study to the Commission. These comments should be reviewed in conjunction with the Study.

The Company recognizes the efforts of the ORS in their extensive review. Duke Energy Carolinas' comments are focused on the recommendations set forth in the conclusion of the Study and are addressed in that order.

- I. Duke Energy Carolinas requests proposals from and evaluates bids from all qualified domestic and international coal suppliers. The Company's

procurement policy is to evaluate all coal purchases on a Btu equivalent, delivered cost basis taking into consideration any impacts and costs related to operations and maintenance, fuel blending costs, and environmental compliance. Duke Energy Carolinas will continue to follow these practices in the future and would only consider "more expensive" markets if such supply options are the only available options to ensure reliable electric service due to supplier or transportation problems.

- II. During the pendency of the Study, Duke Energy Carolinas was in the process of evaluating the potential benefits of using private rail cars for delivering coal. As a result of that evaluation the Company entered into a lease to obtain over 1,200 private rail cars. These private rail cars will be placed into service between September 2006 and February 2007. Duke Energy Carolinas anticipates that this transaction will result in transportation cost savings and coal delivery improvements.
- III. Duke Energy Carolinas has sought the advice of counsel in evaluating the potential legal remedies against the railroads and its suppliers for failure to perform and continues to evaluate its options on an on-going basis. In addition, the Company is participating as a member of the Concerned Captive Coal Shippers group in proceedings before the Surface Transportation Board regarding a Notice of Proposed Rulemaking addressing railroad ratemaking methodologies and a proceeding addressing reasonableness of fuel surcharge practices. The Commission should be aware, however, that the railroads have been unwilling to include performance guarantees or the obligation to pay consequential damages in transportation contracts.
- IV. With respect to its fossil fuel suppliers, Duke Energy Carolinas does have effective provisions structured to encourage timely supply and delivery with effective remedies that are enforced as necessary. With respect to its transportation suppliers, see response to Recommendation III above.
- V. Duke Energy Carolinas does not engage in financial hedging with respect to coal purchases due to the lack of financial/liquid markets. The Company effectively hedges its coal needs by committing a percentage of its needs under fixed price coal contracts for a specific length within a balanced portfolio of purchases. The Company also maintains a portfolio with multiple suppliers to mitigate potential supply interruption risk. Natural gas and fuel oil represent less than 2% of the Company's total fossil fuel expenses in a typical year and are used solely to fuel its combustion turbine peaking units. Duke Energy Carolinas does not hedge natural gas or fuel oil purchase because these fuels are consumed in small quantities and are very unpredictable in use. Additionally, a natural hedge exists as most of the Company's CTs can consume either fuel, allowing gas and fuel oil flexibility based on delivered price.

- VI. Duke Energy Carolinas has been rebuilding its coal inventories and reached its target inventory level in June 2006.
- VII. Duke Energy Carolinas will continue to provide the ORS with copies of its annual updated fuel forecast, monthly over/under cumulative recovery report, notice of significant cumulative recovery trends, notice of significant fuel cost trends and monthly FERC Form 423. The Company agrees to inform the ORS of Requests for Proposal it issues for coal purchases and make copies available upon request.

Duke Energy Carolinas appreciates the opportunity to provide these comments and the Commission's consideration of them.

We will hand deliver an original and one copy of this Response, as currently required by the Commission's e-filing protocol. ORS will also be provided with a copy of this Response. If you have questions or concerns, please do not hesitate to contact the undersigned.

Respectfully Submitted,

/S/

William F. Austin
Richard L. Whitt
(803) 251-7442

Lara Simmons Nichols
Duke Energy Carolinas
(704) 382-9960

Attorneys for Duke Energy Carolinas

RLW/nc

Enclosure

cc: John W. Flitter
Nanette S. Edwards, Esquire
C. Lessie Hammonds, Esquire
Wendy Cartledge, Esquire
(all of the South Carolina Office of Regulatory Staff)
(all with enclosure)